Box 6

THE GREEK ECONOMIC AND FINANCIAL ADJUSTMENT PROGRAMME

Greece has committed itself to a very significant correction of its fiscal position, which, according to the latest data release by Eurostat, amounted to a general government deficit of 13.6% of GDP in 2009. On 2 May 2010, the Eurogroup Ministers concurred with the European Commission and the ECB that the ability of the Greek government to finance itself in the market is not sufficient and that financial support is warranted to safeguard financial stability in the euro area as a whole. The euro area financial support to Greece, combined with IMF financing, will be provided under strong policy conditionality, on the basis of an ambitious economic and financial adjustment programme submitted by the Greek authorities.[1] This box presents the main features of the Greek

1 The joint financial package amounts to €110 billion to cover the financing needs of Greece over the programme's three-year horizon. Euro area countries stand ready to contribute for their part €80 billion, of which up to €30 billion in the first year.

programme, as described in the Memorandum on Economic and Financial Policies (MEFP) for the years 2010-2013. The box also briefly discusses the experience of other EU countries with large fiscal adjustments.

The main objectives of the Greek economic and financial adjustment programme are to correct fiscal and external imbalances and to restore confidence in the longer-term sustainability of public finances. The programme highlights four areas:

– Fiscal adjustment is the cornerstone of the programme. In this respect, the Greek government is committed to the implementation of durable fiscal consolidation measures of some 11% of GDP in cumulative terms through 2013. The programme envisages additional remedial measures if the deficit were not on course to fall below 3% in 2014. This large fiscal adjustment is needed to put the government debt-to-GDP ratio on a downward trajectory from 2013 onward.

– Incomes policy and a reform of the social security system are to be undertaken to support fiscal adjustment. Realigning incomes to sustainable levels is also deemed necessary to support a reduction in inflation well below the euro area average, and to improve price and cost competitiveness on a lasting basis.

– Financial sector policies are to be implemented to safeguard financial stability. While currently capital buffers are seen as reassuring, bank supervisors will need to monitor closely liquidity and non-performing loans at individual banks. The Bank of Greece and the government are committed to further strengthening the financial crisis management framework, inter alia by establishing a Financial Stability Fund (FSF). The objective of the FSF is to maintain the stability of the Greek banking system by providing equity capital in the event of a significant decline in capital buffers.

– Structural reforms are to be adopted, focusing on modernising the public sector and making product and labour markets more efficient and flexible. This will serve to create a more open and accessible domestic environment for foreign investors, and to reduce the state's involvement in economic activities. All these measures will contribute to enhancing potential growth.

The Governing Council of the ECB welcomed the economic and financial adjustment programme. The ambitious fiscal consolidation and structural reforms under the programme are appropriate to achieve the programme's objectives of stabilising the fiscal and economic situation over time and addressing the fiscal and structural challenges of the Greek economy. The programme is comprehensive and supported by strong conditionality. It deals with the relevant policy challenges in a decisive manner. Accordingly, it will help to restore confidence and safeguard financial stability in the euro area. The Governing Council also considered essential that the Greek public authorities stand ready to take any further measures that may become appropriate to achieve the objectives of the programme.

Large fiscal adjustments in other EU countries

The economic and financial adjustment programme to which Greece is committed requires strong fiscal consolidation. Judging from past experience in euro area countries, large

Periods of sizeable government debt reduction in selected euro area countries

(general government; percentage of GDP)

Country/period of sizeable debt reduction	Debt		Expenditure		Revenue		Primary expenditure	
	Peak	Trough	Peak	Trough	Peak	Trough	Peak	Trough
Belgium (1994-2007)	134.2	84.2	54.9	48.4	47.5	48.2	44.2	44.5
Ireland (1994-2006)	94.1	24.9	44.6	34.4	41.9	37.4	38.0	33.4
Spain (1997-2007)	67.4	36.2	43.2	39.2	38.4	41.1	38.0	37.6
Netherlands (1994-2007)	78.5	45.5	55.7	45.5	52.9	45.7	49.6	43.3
Finland (1995-2008)	57.7	34.2	63.5	49.4	56.8	53.6	59.4	48.0
Memo item: fiscal position in Greece	Debt		Expenditure		Revenue		Primary expenditure	
2009	115.1		50.5		36.9		45.4	

Source: European Commission Spring 2010 Forecast.
Notes: Since budgetary figures for Spain according to ESA 95 definitions are available only from 1995 onwards, previous values have been interpolated. The peak of the respective fiscal aggregate refers to the year prior to the start of the period of sizeable debt reduction.

reductions in government debt are feasible. Such reforms indeed require a firm longer-term commitment.[2] In particular Belgium, Ireland, Spain, the Netherlands and Finland have in the past implemented substantial budgetary adjustments (complemented by structural reforms) and successfully reduced their debt-to-GDP ratios. The budgetary adjustment in these countries mainly occurred on the expenditure side (see table). The periods of large debt reductions in Ireland, the Netherlands and Finland were accompanied by decreases in the respective government expenditure ratios of more than 10 percentage points. While part of this decline may be explained by the reduction in interest payments, primary expenditure ratios also fell markedly over these periods. These sharp declines even allowed countries to reduce their revenue ratios and still achieve budgetary improvements over the respective debt reduction periods. In Belgium and Spain, expenditure ratios also declined, but fiscal adjustment consisted of increases in revenue ratios too.

Recent experience in several non-euro area Member States participating in ERM II also demonstrates that adverse budgetary developments can be counteracted through decisive fiscal adjustment. For example, the consolidation packages adopted by the Estonian authorities in the course of 2009 amounted to over 9% of GDP, according to the latest European Commission estimates.[3] Lithuania implemented consolidation measures of around 8% of GDP in 2009, with further fiscal adjustment envisaged for 2010. Similarly, after adopting a highly restrictive supplementary budget in 2009, Latvia's 2010 budget contains a further consolidation effort amounting to more than 4% of GDP. These adjustments are crucial in the context of sharp declines in revenues as a result of the economic downturn.

Overall, the ambitious Greek economic and financial adjustment programme, if carried out with determination, can be expected to deliver the necessary correction of fiscal and external imbalances and to restore confidence in the longer-term sustainability of public finances.

2 See the box entitled "Experience with government debt reduction in euro area countries" in the September 2009 issue of the Monthly Bulletin.
3 See European Commission Spring 2010 Forecast.